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Want to Fix the Deficit? Get Real

By Ezra Klein - Mar 11, 2013

This week marks the beginning of the U.S. budget season. Representative [Paul Ryan](#) of [Wisconsin](#) will present the budget for [House Republicans](#). Senator [Patty Murray](#) of [Washington](#) will, for the first time since 2009, present a budget on behalf of [Senate Democrats](#). In a few weeks, the [Barack Obama](#) administration will publish its own budget. In honor of the occasion, Americans everywhere will wear traditional budget-season hats and eat the customary budget- season meals, which include, of course, a rich dessert that we assume will be offset by future [weight loss](#).

OK, that last part is just what we do in my house.

Behind all these appendix-heavy documents lurks the specter of our budget deficits, which have emerged as pretty much the only problem in Washington that both parties can agree to focus on (sorry, millions of jobless Americans). But what kind of problem, exactly, do our budget deficits present? Here are three ways to think about them:

1. We're experiencing severe and measurable economic drag from today's deficits.
2. We're not experiencing measurable economic drag from today's deficits, but we're worried about future deficits implied by today's policies and demographic trends.
3. We're not experiencing severe and measurable economic drag from today's deficits, but we're worried about future deficits implied by today's policies and demographic trends, and we're also concerned about the likelihood of additional budget- busting policies that some future Congress might pursue.

If you guessed No. 3, then congratulations! You get a double serving of budget-season cake. Delicious.

Generous Offer

Today's deficits are, if anything, too small. Yes, I said it. Too. Small. We've seen real, clear damage from spending cutbacks -- if public employment had remained steady since 2008, unemployment would be down to about 7.1 percent -- and the world is begging us to borrow more money. In fact, they're paying us to borrow more money; real [interest rates](#) on Treasury debt have, amazingly, turned negative. We should accept the world's generous, limited-time offer.

This is the moment to pass a big tax cut for employers who hire new workers, to rebuild our infrastructure at bargain- basement rates, and to help state and local governments reverse the deep cuts they've made in recent years. It's not the moment to begin sequestration.

Future deficits are a legitimate concern. But as either [Yogi Berra](#) or Niels Bohr said, predictions are very difficult, especially about the future. And future deficits are, annoyingly, situated entirely in the future. So most everyone in Washington has outsourced the difficult task of estimating future deficits to the genial and diligent wonks at the [Congressional Budget Office](#).

The CBO has come back with two projections. One is a simple, mechanical projection of future deficits based on current law. Everyone pretty much ignores this analysis, because, in recent years, current law has been a poor predictor of future policy. The law said, for instance, that all the Bush tax cuts would expire at the end of 2012 and that huge Medicare cuts would be imposed. Everyone knew that Congress wouldn't let that happen, and that the current-law projection was wrong.

Recognizing this, the CBO constructed another projection it calls the “alternative fiscal scenario.” A better name might be the “Washington is incredibly irresponsible” scenario. Under this model, all of President [George W. Bush](#)’s tax cuts are extended, the automatic budget cuts known as sequestration neither happen nor are replaced by other cuts, the cost controls in Obama’s Affordable Care Act are repealed, spending on Iraq and [Afghanistan](#) continues indefinitely, and so forth.

Still Wrong

Policy makers, pundits and others almost exclusively use this model to stoke Washington’s deficit anxieties. This model, too, is wrong. Although most of the Bush tax cuts expired, some didn’t -- producing more than \$600 billion in revenue over 10 years. Likewise, sequestration’s budget cuts have actually begun, and the costly wars in Iraq and Afghanistan are ending.

At the left-leaning Center for American Progress, [Michael Linden](#) pulled together an [illuminating analysis](#) of exactly what assumptions lurk behind the alternative fiscal scenario’s odd projections. He begins with the most recent long-term budget outlook, from June 2012, which projects that, without a change in policies, debt in 2037 will be at a truly scary 199 percent of gross domestic product.

Yet by incorporating reality as we know it -- the tax increases that passed in January, some recent changes the CBO made to its estimate of federal spending in the next decade, and the drawdown of the wars in Iraq and Afghanistan -- Linden brings the projected debt down to 169 percent of GDP. Better, but still too high. Then Linden goes deeper.

The CBO estimates for future [tax revenue](#) are a bit strange: The agency expects that tax revenue as a percentage of GDP will hold perfectly steady after 2022. But taxes typically grow faster than the economy. Holding them steady represents an implicit assumption that Congress will actually cut taxes.

“CBO itself acknowledges this fact,” Linden writes. “Under its standard baseline projection, the revenue-to-GDP ratio continues to grow after 2022. By contrast, the Alternative Fiscal Scenario assumes ‘unspecified changes in tax law that would keep revenues constant as a share of GDP after 2022.’” Remove this prediction of future tax cuts and the projected debt falls further -- from 169 percent of GDP to 153 percent.

The CBO also assumes large spending increases with no offsets. In recent years, spending on programs other than entitlements and health care has fallen to 7.6 percent of GDP. The CBO assumes it will rebound to its historic average of 10.6 percent of GDP. However, if that spending doesn’t rebound, the projected debt tumbles -- from 153 percent of GDP to 112 percent. By the way, all this assumes the repeal of the budget cuts in sequestration.

Finally, while health-care spending typically rises much faster than economic growth, in recent years the rate of growth has slowed considerably. If that trend continues -- unlikely, maybe, but stranger things have happened -- and health costs rise at the same rate as the rest of the economy, debt falls to 97 percent of GDP.

Rejecting Hysteria

Linden’s conclusions are a welcome antidote to the deficit hysteria that permeates Washington. If you don’t assume the budget will be swamped by huge new tax cuts and spending increases, then “implementing an average of about 0.5 percent of GDP in additional annual programmatic spending cuts or tax increases -- or some combination of the two -- would keep the debt level essentially stable for the next 25 years, reducing it to about 71 percent of GDP by 2037,” he writes. “This 0.5 percent of GDP would amount to about \$1 trillion saved over the next 10 years.”

My conclusion is a little bit different. The CBO’s irresponsibility scenario made sense in recent years, when the Bush tax cuts, sequestration and other unresolved fiscal policies made current law a faulty guide to

future deficits. But the CBO's alternative fiscal scenario has become a hindrance to sensible policy making. It misinforms the public (and Congress) about the severity of future deficits, contributes to an air of panic, and, perhaps worst of all, gives Congress an excuse for fiscal irresponsibility, because irresponsibility is already priced-in to the budget projections.

The Bush tax cuts were an excellent example of this perverse dynamic: Because everyone was used to a fake baseline that assumed their full extension, a supposedly deficit-obsessed Congress managed to resolve the so-called fiscal cliff in January by passing a huge tax cut that added trillions to deficits while calling it, amazingly, a fiscally responsible tax increase.

Now that the fiscal cliff and its attendant uncertainty have been resolved, it's time to retire the irresponsibility scenario and rely simply on the current-law scenario. If Congress wants to make our fiscal situation worse by passing irresponsible laws, then so be it. In that case, the CBO can release estimates showing the damage those actual policies would do to the primary deficit projection. But projections based on nonexistent or already rejected policies don't make sense. Predictions are hard enough already. We should stop making them harder and scarier.

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